No. 768 36

In the Supreme Court of the United States

OCTOBER TERM, 1943

MICHAEL F. McDONALD, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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CITATIONS

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OPINIONS BELOW

The findings of fact and opinion of the Tax Court of the United States (R. 115a–118a) are reported in 1 T. C. 738. The opinion of the Circuit Court of Appeals (R. 122a–126a) is reported in 139 F. 2d 400.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on December 9, 1943 (R. 127a). The petition for a writ of certiorari was filed on March 8, 1944. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. May the incumbent, by governor's interim appointment, of a state judicial office deduct a contribution to the party campaign fund and expenses incurred by him in connection with his unsuccessful campaign for reelection for a full term either—

(a) As ordinary and necessary expenses paid in carrying on a trade or business within the meaning of Section 23 (a) of the Internal Revenue Code, as amended by Section 121 of the Revenue Act of 1942; or

(b) As expenses paid for the production of income within the meaning of Section 23 (a) of the Internal Revenue Code, as amended by Section 121 of the Revenue Act of 1942; or

(c) As a loss incurred in a transaction entered into for profit within the meaning of Section 23 (e) (2) of the Internal Revenue Code?

2. Did the Tax Court err in excluding evidence and in making inadequate findings of fact?

STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and regulations are set out in Appendix A, *infra*, pp. 10–13.

STATEMENT

The facts as stipulated (R. 28a–30a) and as found by the Tax Court (R. 115a–116a) may be summarized as follows:

The taxpayer, a resident lawyer of Pennsylvania, was appointed by the Governor of Pennsylvania on December 1, 1938, to fill an unexpired term as a judge of the Court of Common Pleas for the Eleventh Judicial District of Pennsylvania, which district is coextensive with Luzerne County (R. 28a, 115a–116a). The office carried an annual salary of $12,000. At the time of his appointment, taxpayer agreed to be a candidate for the full ten-year term beginning January 1, 1940. He was a candidate to succeed himself, in both the primary and the general elections of 1939. He won in the primary but was defeated in the general election. (R. 116a.)

In order to get the support of the Democratic organization of Luzerne County, taxpayer had to pay the amount "assessed" by the subcommittee of the Democratic Party. Each of the candidates gave the local treasurer authority to expend his contribution, and expenditures from the fund were principally on behalf of all the candidates. Taxpayer contributed $8,000 to the party fund and in addition expended on his own behalf $5,017.27 for advertising, traveling, and other expenses in connection with his campaign. He received a contribution of $500 from his son for the purpose of defraying part of his campaign expenditures. (R. 116a.)

In his income tax return for the taxable year 1939, which was filed on a cash receipts and disbursements basis, the taxpayer deducted $13,017.27

"as reelection expenses." The Commissioner disallowed the amount claimed and found a deficiency in tax of $2,506.77 for the taxable year 1939. (R. 115a.) The Tax Court sustained the deficiency in tax (R. 119a) and the Circuit Court of Appeals affirmed (R. 127a).

ARGUMENT

This case does not warrant further review. As petitioner recognizes (Pet. 5, 9, 10), there is no conflict. The decision is in accord with prior decisions of the Tax Court, which has consistently denied deductions for campaign contributions and campaign expenses by a candidate for office.[1] The decision, moreover, is in accord with express provisions of Treasury Regulations and is plainly correct.[2]

1. Section 23 (a) (1) of the Internal Revenue Code (Appendix A, *infra*, p. 10) allows deduction only for those ordinary and necessary expenses which are paid or incurred in carrying on a trade or business. Section 48 (d) of the Internal

[1] *Reed* v. *Commissioner*, 13 B. T. A. 513, reversed on another issue, 34 F. 2d 263 (C. C. A. 3d), reversed, 281 U. S. 699; *Lindsay* v. *Commissioner*, 34 B. T. A. 840.

[2] Sec. 19.23 (o)-1 of Regulations 103, promulgated under the Internal Revenue Code (Appendix A, *infra*, p. 13) prohibits the deduction of all contributions for campaign expenses without exception. Sec. 19.23 (a)-15 [as added by T. D. 5196, 1942-2 Cum. Bull. 96], (Appendix A, *infra*, p. 12) prohibits the deduction of campaign expenses of a candidate for public office. See also Sec. 19.23 (a)-1 and Sec. 19.23 (a)-5 (Appendix, *infra*, p. 11).

Revenue Code provides that the term "trade or business" includes the performance of the functions of a public office. Petitioner has not, however, shown that the disbursements of his unsuccessful campaign were directly connected with carrying on the business in which he was engaged, i. e., acting as county judge. Cf. *Higgins* v. *Commissioner*, 312 U. S. 212; *Kornhauser* v. *United States*, 276 U. S. 145.

It is apparent that the expenses here sought to be deducted were not incurred in performance of the judicial duties of the office which, at the time of incurring the expenses, was the taxpayer's "business." Rather, they resulted from "running for office" which certainly is not a business carried on for profit though income results from performance of duties if one is elected. The contribution of $8,000 to the general party fund was to promote the success of all the candidates (R. 116a). As the Tax Court held (R. 117a), these campaign expenses had no relationship to the functioning of the judicial office held by the taxpayer.

The expenses here were personal rather than business expenses. They were antecedent to, and anticipatory of, attaining judicial office and fall under the ban of Section 19.23 (a)-15 of Treasury Regulations 103 (Appendix A, *infra*, p. 12) denying a deduction for expenses incurred in seeking employment or placing oneself in a position to render personal services, because such personal

expenses are expressly excluded as deductible by Section 24 of the Code (Appendix A, *infra*, p. 11).

2. The taxpayer next claims the expenses are deductible under Section 23 (a) (2) of the Internal Revenue Code, as amended by Section 121 of the Revenue Act of 1942 (Appendix A, *infra*, p. 10), as nontrade or nonbusiness expenses.[3] This amendment resulted from the decision in *Higgins* v. *Commissioner*, 312 U. S. 212, denying a deduction for expenses incurred in connection with managing the taxpayer's investments because such management did not constitute a trade or business. The purpose of the amendment and its restrictions are set out in S. Rep. No. 1631, 77th Cong., 2d Sess., pp. 87–88 (Appendix B, *infra*, pp. 14–15).[4] As stated in the opinions below (R. 117a–118a, 126a), it was never designed to cover expenses of the type found in the present case. Furthermore, Section 19.23 (a)–15 of Treasury Regulations 103, promulgated under Section 121, as amended by T. D. 5196 (Appendix A, *infra*, p. 12), expressly exclude "campaign expenses" as a deductible item of nontrade or nonbusiness expense. The taxpayer is attempting to bring within this amendment expenses which are personal to him. The amendment does not cover such expenses. Under the regulations, personal expenses are expressly excluded: the committee

[3] The amendment was by Section 121 (e) given retroactive application to all prior Revenue Acts.

[4] See also H. Rep. No. 2333, 77th Cong., 2d Sess., pp. 74–75.

reports, *supra,* show the purpose to subject the amendment to all the restrictions and limitations that apply under Section 23 (a) (1) except the requirement of being incurred in connection with a trade or business.

3. The taxpayer next claims that the expenditures are deductible as a loss under Section 23 (e) of the Internal Revenue Code (Appendix A, *infra,* pp. 10–11). The loss provisions do not apply to all out-of-pocket disbursements for which the taxpayer receives no immediate tangible benefit. Cf. *Kornhauser* v. *United States,* 276 U. S. 145, 152. Election expenditures are not deductible losses under Section 23 (e) (2) because they are not "incurred in any transaction entered into for profit." There is no pecuniary profit in running for election, the only transaction in which the expenses were incurred. As the Tax Court pointed out (R. 117a), the judicial salary is paid for performing the functions of judge, not for winning an election.

Furthermore, as pointed out by the Circuit Court of Appeals (R. 125a), the money disbursements were not the involuntary parting with something of value contemplated by the statute as constituting a deductible loss. Failure to realize a desired profit is not of itself a loss. Cf. *Hort* v. *Commissioner,* 313 U. S. 28, 32–33. To be deductible, a loss must be one which is not compensated for by insurance *or otherwise* (Section

23 (e), Appendix, *infra*, pp. 10–11). Here the taxpayer received a *quid pro quo* for his expenditures. He received the support of his party, he obtained publicity and value in the form of advertising, clerical assistance, and the transportation paid for. (R. 116a.) Since he received value for his expenditures a loss cannot be claimed for the outlay. He did not lose the expenditures; he engaged in making them. He acquired something in return. True, he lost in the election and in a sense he lost the emoluments of an office which his defeat prevented him from obtaining, but the tax law does not grant a deduction for the loss of anticipatory income (*Hort* v. *Commissioner*, *supra*).

4. There is no substance in the error assigned (Pet. 5) to the exclusion by the Tax Court of evidence that the expenses were "ordinary and necessary." We may assume that the expenses were ordinary and necessary campaign expenses permitted by the Election Code of Pennsylvania.[5] The decisions below correctly held that the expenditures were not business expenses; therefore it is irrelevant whether they were ordinary and necessary.

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[5] The applicable statutory provisions of that Code are set out in the appendix to the petition for certiorari and brief (pp. 20–22).

CONCLUSION

The decision below is correct, there is no conflict, and the petition should be denied.

Respectfully submitted.

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MARCH 1944.

APPENDIX A

Internal Revenue Code:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) [as amended by Section 121 of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Expenses.*—

(1) *Trade or Business Expenses.*—

(A) *In General.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business: * * *.

* * * * * *

(2) *Non-Trade or Non-Business Expenses.*—In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income.

* * * * * *

(e) *Losses by Individuals.*—In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

(1) if incurred in trade or business; or

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business; * * *.

* * * * * *

(26 U. S. C., Sec. 23.)

SEC. 24. ITEMS NOT DEDUCTIBLE.

(a) *General Rule.*—In computing net income no deduction shall in any case be allowed in respect of—

(1) Personal, living, or family expenses; * * *.

* * * * * *

(26 U. S. C., Sec. 24.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

SEC. 19.23 (a)-1. *Business expenses.*—Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business * * *.

* * * * * *

SEC. 19.23 (a)-5. *Professional expenses.*—A professional man may claim as deductions the cost of supplies used by him in the practice of his profession, expenses paid in the operation and repair of an automobile used in making professional calls, dues to professional societies and subscriptions to professional journals, the rent paid for office rooms, the cost of the fuel, light, water, telephone, etc., used in such offices, and the hire of office assistants. Amounts currently expended for books, furniture, and professional instruments and equipment, the useful life of which is short, may be deducted.

SEC. 19.23 (a)-15. [as added by T. D. 5196, 1942-2 Cum. Bull. 96.] *Nontrade or nonbusiness expenses.*—

* * * * *

(b) Except for the requirement of being incurred in connection with a trade or business, a deduction under this section is subject to all the restrictions and limitations that apply in the case of the deduction under section 23 (a) (1) (A) of an expense paid or incurred in carrying on any trade or business. This includes restrictions and limitations contained in section 24, as amended. * * *

Capital expenditures, and expenses of carrying on transactions which do not constitute a trade or business of the taxpayer and are not carried on for the production or collection of income or for the management, conservation, or maintenance of property held for the production of income, but which are carried on primarily as a sport, hobby, or recreation are not allowable as nontrade or nonbusiness expenses. * * *

Among expenditures not allowable under section 23 (a) (2) are the following: Commuters' expenses; * * * expenses in seeking employment or in placing oneself in a position to begin rendering personal services for compensation, campaign expenses of a candidate for public office, bar examination fees and other expenses incurred in securing admission to the bar, and corresponding fees and expenses incurred by physicians, dentists, accountants, and other taxpayers for securing the right to practice their respective professions.

* * * * *

SEC. 19.23 (o)–1. *Contributions or gifts by individuals.*—

* * * * * * *

* * * contributions for campaign expenses, are not deductible from gross income.

* * * * * *

APPENDIX B

S. Rep. No. 1631, 77th Cong., 2d Sess., pp. 87–88:

SECTION 121. NON-TRADE OR NON-BUSINESS DEDUCTIONS.

* * * The amendment made by this section allows a deduction for the ordinary and necessary expenses of an individual paid or incurred during the taxable year for the production and collection of income, or for the management, conservation, or maintenance of property held by the taxpayer for the production of income, whether or not such expenses are paid or incurred in carrying on a trade or business, and also allows a deduction for the exhaustion and wear and tear (including a reasonable amount for obsolescence) on property held for the production of income, whether or not such property is used by the taxpayer in a trade or business.

For an expense to be deductible under this section, it must have been incurred either (1) for the production or collection of income, or (2) for the management, conservation, or maintenance of property held for the production of income. Ordinary and necessary expenses so paid or incurred are deductible under section 23 (a)(2) even though they are not paid or incurred for the production or collection of income of the taxable year or for the management, conservation, or maintenance of property held for the production of such income. The term "income" for this purpose comprehends not merely income of the tax-

able year but also income which the taxpayer has realized in a prior taxable year or may realize in subsequent taxable years, and is not confined to recurring income but applies as well to gain from the disposition of property. Expenses incurred in managing or conserving property held for investment may be deductible under this provision even though there is no likelihood that the property will be sold at a profit or will otherwise be productive of income, and even though the property is held merely to minimize a loss with respect thereto. The expenses, however, of carrying on a transaction which does not constitute a trade or business of the taxpayer and is not carried on for the production of income or for the management, conservation, or maintenance of property, but which is carried on primarily as a sport, hobby, or recreation are not allowable as non-trade or non-business expenses.

Expenses, to be deductible under section 23 (a) (2), must be ordinary and necessary, which rule presupposes that they must be reasonable in amount and must bear a reasonable and proximate relation to the production or collection of income, or to the management, conservation, or maintenance of property held for that purpose.

A deduction under this section is subject, except for the requirement of being incurred in connection with a trade or business, to all the restrictions and limitations that apply in the case of the deduction under section 23 (a) (1) (A) of an expense paid or incurred in carrying on any trade or business.

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